Hershey Foods Corporation

1989
ANNUAL
REPORT

Hershey Foods Corporation

Hershey Foods Corporation, which includes Hershey Chocolate U.S.A., Hershey Canada Inc., Hershey International and Hershey Pasta Group, produces a broad line of chocolate, confectionery and pasta products. Hershey Chocolate U.S.A.'s principal brands include *Hershey's, Reese's, Y&S, Luden's, Peter Paul,* and *Cadbury's.* Hershey Canada's major brands, in addition to *Hershey, Reese* and *Y&S,* include *Oh Henry!, Life Savers, Lowney, Moirs,* and *Planters.* Hershey International's business consists primarily of export sales of chocolate and confectionery products manufactured by Hershey Chocolate U.S.A., and joint venture operations in foreign countries. Hershey Pasta Group produces nine principal regional brands: *American Beauty, San Giorgio, Skinner, Delmonico, P&R, Perfection, Light 'N Fluffy, Pastamania,* and, since February 1990, *Ronzoni.* Distributed throughout the continental United States, with the exception of portions of New England, the Pasta Group's brands are recognized leaders in their individual regions.

Contents

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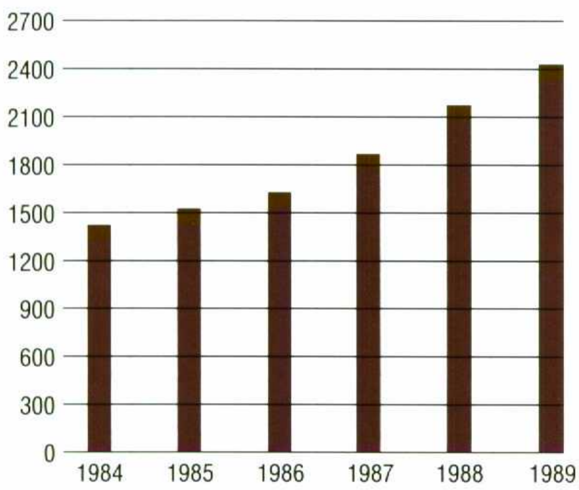
1989 Financial Highlights

(in thousands of dollars except shares and per share amounts)	**1989**	1988	Percent Change
Net sales	**$2,420,988**	$2,168,048	+12
Income from continuing operations	**171,054**	144,506	+18
Net income	**171,054**	213,949	−20
Income from continuing operations per share	**1.90**	1.60	+18
Net income per share	**1.90**	2.37	−20
Cash dividends paid per share:			
Common Stock	**.740**	.660	+12
Class B Common Stock	**.665**	.595	+12
Total cash dividends paid	**65,592**	58,530	+12
Capital additions	**162,032**	101,682	+59
Stockholders' equity at year-end	**1,117,050**	1,005,866	+11
Net book value per share at year-end	**12.39**	11.15	+11
Price per share of Common Stock at year-end	**35⅞**	26	+38
Outstanding shares at year-end	**90,186,336**	90,186,336	—

Total shares of 90,186,336 were outstanding throughout the two-year period and at December 31, 1989, consisted of 74,907,032 shares of Common Stock and 15,279,304 shares of Class B Common Stock. Income from continuing operations per share and net income per share are based on weighted average outstanding shares of 90,186,336 for 1989 and 1988.

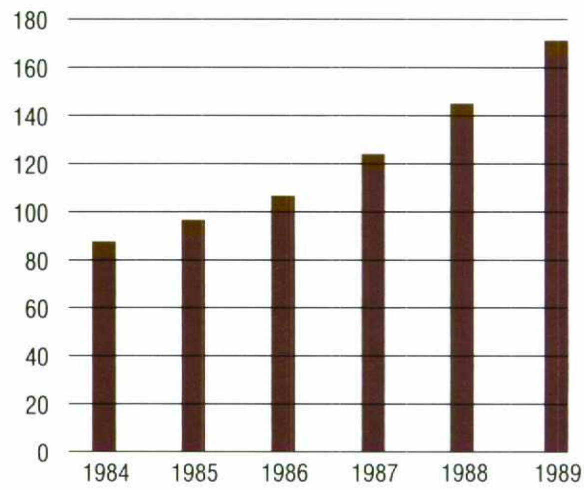
NET SALES

(dollars in millions)



INCOME FROM CONTINUING OPERATIONS

(dollars in millions)



LETTER TO STOCKHOLDERS

Your Corporation had an excellent year in 1989. It was a year of sharpened focus which resulted in a higher rate of profitable growth. Three of our divisions, Hershey Chocolate U.S.A., Hershey Pasta Group and Hershey International, posted excellent performances. While Hershey Canada Inc. did not achieve its objectives for the year, we remain confident in its longer-term ability to generate above-average growth and returns in the difficult Canadian market.

The 1988 acquisition of the Peter Paul/Cadbury confectionery business in the United States increased the focus of our confectionery portfolio. This led to a revised Corporate Mission Statement in order to provide the proper sense of direction to our employees in 1989 and subsequent years. Our new Mission Statement reads as follows: Hershey Foods Corporation's mission is to become a major diversified food company and a leading company in every aspect of our business as:

Hershey Foods' mission is to become a major diversified food company and a leading company in every aspect of our business.

- The number-one confectionery company in North America, moving toward worldwide confectionery market share leadership.

- A respected and valued supplier of high quality, branded consumer food products in North America and selected international markets.

The first part of the mission has been accomplished. Hershey Foods is the leading confectionery company in North America in market share. Furthermore, we will continue to strive diligently to enhance our North American share of market and also expand our presence in other parts of the world which offer profitable growth and adequate return opportunities. Strategic alliances, acquisitions and other entry strategies will be pursued to accomplish this goal.

The second part of the Mission Statement reflects our determination to grow non-confectionery brands, including cocoa, syrup and chocolate drinks, and, importantly, to enhance the strategic role of our pasta operations. On February 12, 1990, we announced the acquisition of Ronzoni Foods Corporation; this business combination strengthens our domestic pasta market share and enhances our role as the number-two branded pasta supplier in this country. In addition, we plan to be a significant factor in the United States and in selected international markets with these and other grocery products carrying the *Hershey's* or other well-known brand names.

An important step in the continuation of our confectionery market share leadership in the United States was the addition of the Peter Paul/Cadbury brands. Equally important was the 1989 progress toward a smooth and complete integration of this business into our Hershey Chocolate U.S.A. division. We are pleased to report that the integration process is ahead of schedule, and significant efficiencies have been achieved through this business combination.

The Corporation achieved substantial sales growth in 1989 through long-established brands — a key objective of our operating plan. As an example, our brand leader, *Reese's* peanut butter cups, improved its market share position substantially.

The Corporation achieved substantial sales growth in 1989 through long-established brands — a key objective of our operating plan.

Likewise, a significant sales contribution from new products is an important part of our long-term growth strategy. It is in this area that your management strives to achieve a balance between short-term operating results and investments required to produce suitable rewards in the longer term. Frankly, our businesses have introduced more than a dozen new products in the past few years. Most are proving to be successful, but all require

Richard A. Zimmerman (left), Chairman of the Board and Chief Executive Officer, and Kenneth L. Wolfe, President and Chief Operating Officer

significant financial investment, especially in marketing.

Our *Symphony* chocolate bar, in its two versions, moved into national distribution. Five new baking items were introduced in selected markets. The excellent consumer response to the *5th Avenue* bar during its first year in full national distribution also was gratifying.

Promising new products are in test market. Especially noteworthy is *Perfection* microwave pasta, the first pasta made exclusively for microwave cooking.

As a means of capitalizing on Hershey's reputation as the premier chocolate maker in the United States, our newly-formed Venture Group introduced a line of chocolate bar flavored puddings to selected East Coast markets in late 1989.

Hershey Canada did not produce the results we had hoped for during the year, with sales and earnings below 1988 levels. Major changes were made to the Division's manufacturing operation through the closing of one major facility, and the combining of manufacturing operations in, and expansion of, our existing facility at Smiths Falls, Ontario. These moves are designed to improve future profitability by eliminating excess production capacity.

At the end of the year, Richard W. Meyers was named President of the Canadian operation. Mr. Meyers has been with Hershey Foods Corporation since 1967 and previously was General Manager of Hershey Canada's Chocolate Business Unit.

A significant sales contribution from new products is an important part of our long-term growth strategy.

On April 24, 1989, Thomas C. Graham, President of USS, a division of USX Corporation, was elected to the Board of Directors. We welcome the wealth of knowledge and experience he brings to our Board of Directors.

In addition to substantial investments in marketing and new products, we continued to invest heavily in capital additions during 1989 to meet demand for our products. Modernization of our production facilities also continued. A major project scheduled for completion in 1992 is the construction of a modern, more efficient chocolate-processing facility in Hershey, Pa. The Corporation's growth also has led to a decision to construct a new office building and data center in Hershey.

While we remain convinced that the long-term profitable growth of our businesses will

depend on appropriate levels of capital investment, we also are mindful of the stockholders' desire for an adequate return on their investment. We always have attempted to balance the cash dividend needs of stockholders with the cash demands of our businesses. In 1989, the dividend on the Corporation's Common Stock was increased for the 15th consecutive year. Dividends paid on the Common Stock in 1989 were $.74 per share, a 12 percent increase over the previous year's dividends paid. Over the past five years, our Common Stock dividend has grown at a compound rate of 12 percent.

In addition to substantial investments in marketing and new products, we continued to invest heavily in capital additions during 1989 to meet demand for our products.

Unquestionably, the Corporation benefited from lower overall commodity costs in 1989 because of lower cocoa bean prices. Even more importantly, the cost of manufacturing in 1989 was reduced through the continued effectiveness of our productivity and quality improvement programs. Over the past five years, a subtle but extremely important change has occurred in our business. Our gross margin has been affected favorably by lower manufacturing costs through modernization, more efficient utilization of facilities, and productivity improvements, while we have maintained or improved the quality of our products. We have reinvested our increased gross profit in significant increases in selling and marketing expenditures, with notable increases in market share. At the same time, we have achieved strong growth in earnings.

The commitment to providing the best quality products and services to our customers was reaffirmed and strengthened in 1989, leading to higher levels of productivity.

Employee involvement, particularly through a formalized "Quality Through Excellence" program, has enabled everyone to work more efficiently and deliver higher quality results. Throughout the Corporation, the commitment to providing the best quality products and services to our customers was reaffirmed and strengthened during 1989. The increase in the Corporation's earnings is a tribute to our employees' excellent work, which is highlighted by their determination to improve productivity and quality. Their efforts truly make Hershey Foods an investment in excellence. ■

Richard A. Zimmerman
Chairman of the Board and
Chief Executive Officer

Kenneth L. Wolfe
President and Chief
Operating Officer

POSITIONED FOR GROWTH

Hershey Foods has completed ten years of the most significant growth we have ever experienced — a period that has prepared us well for additional growth in the 1990s and beyond.

Our long-term growth strategy is designed to optimize earnings over time for the benefit of all stockholders through ongoing programs to enhance market share, expand our business base, and leverage our strengths. We have been successful with this strategy; our stock price appreciated about 800 percent in the period 1979 – 1989, ranking Hershey Foods as a top market performer.

While we will continue to pursue significant growth of our established confectionery brands in North America, we recognize the strategic importance of expanding our business in international markets. Our expansion in the world-wide confectionery market will come from the combination of increased exports, joint ventures, acquisitions, licensing agreements and other business arrangements. We actively are pursuing this international growth strategy and have positioned ourselves, both operationally and financially, to meet this goal.

In addition, we plan to grow our non-confectionery related businesses, especially our pasta operations. America's love affair with pasta has not cooled; per capita consumption has increased about 25 percent since 1983. Nearly 25 years ago, Hershey Foods was the first major corporation to recognize pasta as a growth category. We acquired the San Giorgio business in 1966 and, through the years, have added other popular pasta brands. The recent acquisition of Ronzoni Foods Corporation has further enhanced our position in this market and has strengthened our base for future growth.

Demographically, the current baby boom generation is providing a significant number of new consumers to the confectionery market. Longer term, however, we have recognized that the average age of the consumer is increasing, and we have taken steps to capitalize on this growing adult market. New candy bar introductions such as *Skor, Bar None, 5th Avenue,* and *Symphony* have shown particular appeal for adults. Other products such as *Kit Kat* and *Reese's* peanut butter cups continue their strong appeal across all age groups.

Significant investment in the research and development of new products has major implications for our long-term growth prospects. We have attempted to build a new product development process that is more long-term oriented — driven by quality rather than sheer quantity. We expect to remain the leader in the confectionery industry in new products and have built the infrastructure to ensure a steady stream of successful new products in the future.

Hershey Foods competes in a world where increases in the cost of certain raw materials, packaging, labor, distribution, and general overhead such as medical benefit costs are a fact. While we certainly are not insulated from these factors, we have affected favorably our gross margin through more efficient manufacturing operations and corporate-wide productivity improvements, while maintaining or enhancing the quality of our products. The combination of these elements has allowed us to provide increased advertising and promotional support for products, which, in turn, led to an increase in market share and profits, a growth trend we plan to continue.

By the year 2000, America's workforce will have experienced dramatic growth in the number of women and minorities. Hershey Foods is taking steps to develop a workplace diversity program, recognizing that the company that values and manages cultural diversity will have the competitive edge in attracting and retaining the most qualified employees.

Overall, we believe our game plan for long-term growth is sound and will continue to guide us as we approach our 100th anniversary in 1994 and move beyond this milestone into the 21st century. The strength of the *Hershey* name — recognized for quality, value and leadership — combined with the financial flexibility of our organization, convince us that we can accomplish these goals and, thereby, provide increased stockholder value over time. ■

Operations Review

Hershey Chocolate U.S.A.

Hershey Chocolate U.S.A., the Corporation's largest division, achieved record sales and earnings in 1989 as a result of six important factors: the successful integration of the Peter Paul/Cadbury business; strong unit volume growth of established brands; the success of new product introductions; the effectiveness of selling and marketing programs; substantial capital investment to expand capacity, modernize and improve productivity; and the lower net cost of commodities. Additionally, the sales gain helped the Division enhance its market share leadership position in the U.S. confectionery industry.

Acquired in August 1988, the Peter Paul/ Cadbury business was integrated smoothly into Hershey Chocolate U.S.A. during 1989. While anticipated cost savings and corresponding margin improvements will not be realized fully for several years, considerable progress has been made. Early in the year, the York, Pa., plant was closed and the production of *York* peppermint patties was moved to the Division's Reading, Pa., facility. Sales responsibility for the Peter Paul/Cadbury lines was transferred from food brokers to the Division's confectionery sales force in late 1988. Overhead was reduced when the headquarters support functions of Cadbury's U.S. confectionery operation were assumed by Division personnel based in Hershey.

Modernization and expansion of existing production capacity is a major factor in Hershey Chocolate U.S.A.'s ability to support sales growth. Here, Finished Product Inspector Judy Zimmerman checks the manufacture of *Reese's* peanut butter cups on the Stuarts Draft, Va., plant's new manufacturing line.

Established confectionery brands experienced unit volume growth in 1989 at a rate exceeding that of the industry. Many of the Division's leading brands contributed to this strong performance, including *Kit Kat, Hershey's Miniatures,* and *Reese's* peanut butter cups. Also recording solid performances were *Rolo, Whatchamacallit, Skor, Hershey's Kisses, Hershey's* milk chocolate bar with almonds, *Y&S Nibs,* and *Twizzlers.*

The Peter Paul/Cadbury brands, led by *Cadbury's Mini Eggs, Cadbury's Creme Eggs, Caramello, Peter Paul Almond Joy,* and *Peter Paul Mounds,* posted solid volume gains.

The *5th Avenue* bar, primarily distributed in the northeastern United States prior to September 1988, completed its first full year of national distribution and marketing support in 1989. Acquired as part of the purchase of The Dietrich Corporation in late 1986, the brand subsequently underwent a period of evaluation during which the product's formulation was modified and the *Hershey's* brand name was added to the label.

In its second full year of national distribution, the *Bar None* candy bar achieved its targeted sales level. The brand will continue to be a strong contributor to Hershey Chocolate U.S.A.'s confectionery line.

New products also made an important contribution to the Division's unit volume growth during 1989. The national introduction in August of *Symphony* milk chocolate bar and *Symphony* milk chocolate bar with almonds and toffee chips met with an excellent response. Made with more milk than any other domestic chocolate bar, the distinctive, European-style flavor of *Symphony* appeals to a growing consumer market for this type of chocolate in the United States.

Five new, premium baking products were introduced in the Division's grocery products category in September: *Hershey's* European style cocoa, *Hershey's Premium* milk chocolate chunks, *Hershey's Premium* unsweetened and semi-sweet baking bars, and *Hershey's* vanilla milk chips. These new items were introduced to fill growing consumer demand for more upscale, sophisticated baking products.

Hershey's strawberry syrup, intended to enhance Hershey's strong position in the syrup category, is another new grocery product. Launched nationally in the fall of 1989, *Hershey's* strawberry syrup is especially popular among children and can be used either as a milk flavoring or an ice cream topping.

Hershey's genuine chocolate flavored drink, sold in aseptic packaging, is a good example of the Division's efforts to enter new product categories by building on consumers' strong association between the words "Hershey's" and "chocolate." This product was introduced to selected regional

markets in January 1989, expanded in August to approximately one-third of the nation, and introduced to the rest of the country in January 1990. Aseptic packaging preserves the product's freshness, and refrigeration is required only to chill the drink. While the total aseptic drink category has grown rapidly in recent years, the chocolate drink segment is small and offers Hershey Chocolate U.S.A. an excellent opportunity to expand this portion of the market.

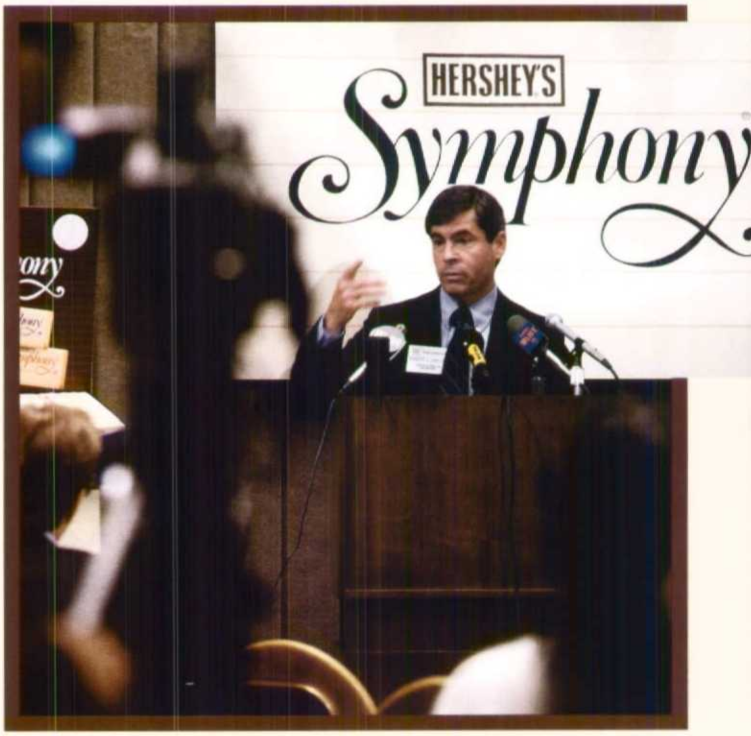
A highly professional sales force is of critical importance in the packaged food business, whether the objective is to gain rapid national acceptance of a new product or to ensure continued growth of established brands. Early in 1989, the Division's sales force was restructured into two separate sales groups, one devoted to confectionery and the other to grocery products such as syrups, powdered cocoa and baking chips. Since each product category usually is sold to a different supermarket buyer, the new system allows confectionery sales personnel to devote more attention to their product lines. This became especially important following the addition of the Peter Paul/Cadbury products, which had their full sales volume impact during 1989.

The separate grocery sales group now will be able to enhance this important part of the Division's business by concentrating on selling products to chain grocers, wholesale grocers and wholesale clubs, three classes of trade which account for the major portion of the Division's grocery sales.

Hershey Chocolate U.S.A. has increased marketing expenditures substantially in recent years, resulting in significant sales growth. This spending has been in support of established brands, as well as new products.

In order to continue to provide high quality products for its growing business, the Division invests in capital additions to ensure sufficient manufacturing capacity, to modernize operations, to properly maintain equipment and plants, and to rationalize facilities as required.

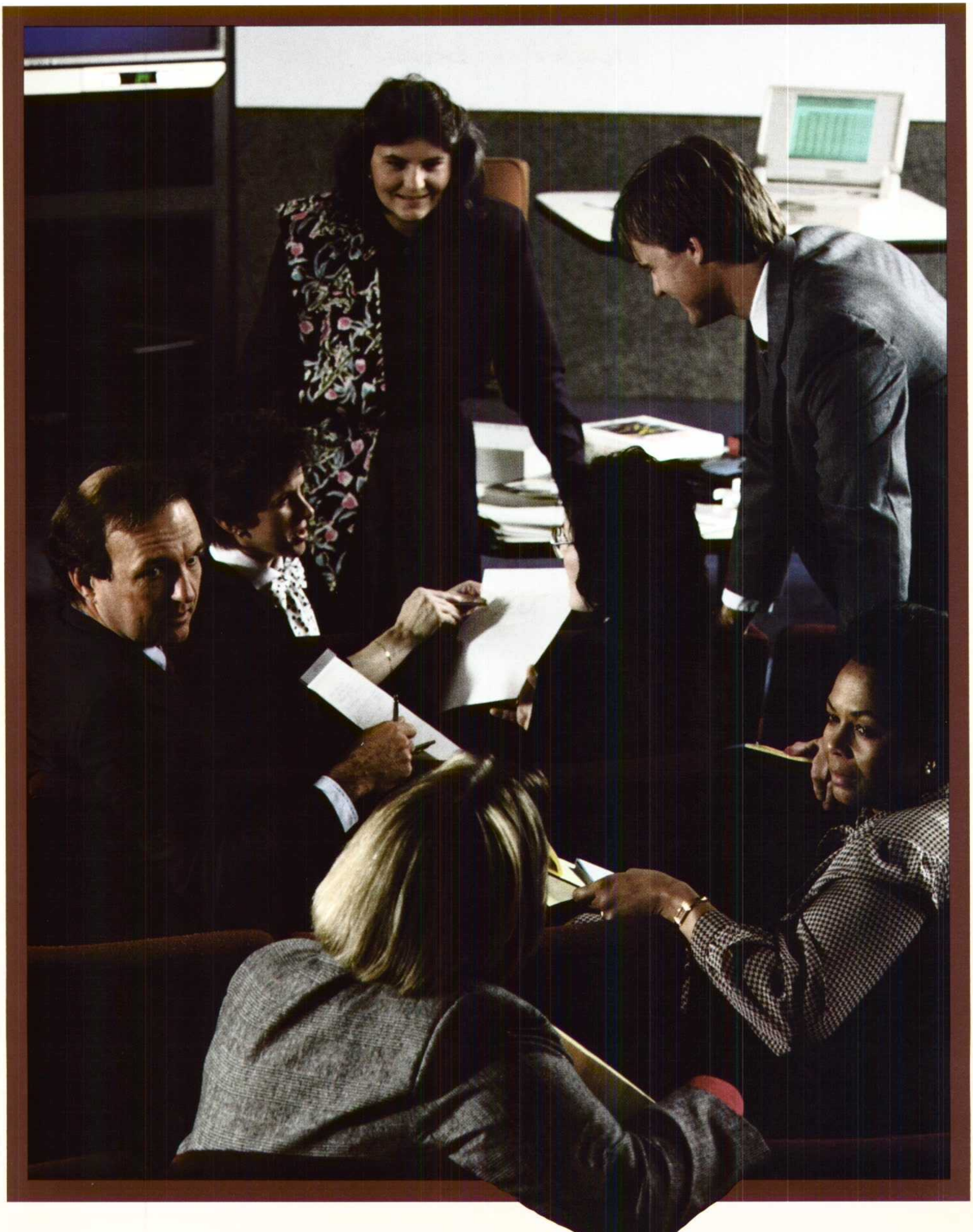
A major new *Reese's* peanut butter cup line began operation in the Stuarts Draft, Va., plant during the year. This was the most significant of several projects to expand production capacity for this rapidly growing confectionery brand. In addition, the Division's flow of new products required significant investment in production equipment.



Continuing development and introduction of successful new products, such as *Symphony* chocolate bar, reinforces Hershey Chocolate U.S.A.'s leading position in the industry. Early sales results show that the national introduction of *Symphony*—here announced by Rob Shelton, Director of Marketing, Moulded Bars, at a September press conference—struck a responsive chord with consumers.

In 1989, the Hershey PC Users Group steering committee entered its third year of providing assistance to employees in the utilization of computers. The group meets regularly to review various technological advancements and information management topics, areas offering significant potential for enhanced productivity.

The ongoing programs of plant rationalization and modernization, which will pay long-term dividends in terms of increased productivity, also required significant capital investment during 1989. As mentioned earlier, the York, Pa., plant was closed in January 1989, and the production of all peppermint pattie products was centralized in the Reading, Pa., plant. Late in 1989, the Division's Moline, Ill., plant was closed, and production of *Y&S Nibs, Twizzlers,* and *Shoestrings* was transferred to the main Y&S plant in Lancaster, Pa. The decision to close both of these facilities was based on the age and design of



the facilities, neither of which were conducive to modernization.

The Corporation has undertaken a significant modernization program at the Peter Paul plant in Naugatuck, Conn. When finished, the modernized plant will be much more efficient and capacity will be enhanced significantly.

In mid-1989, Hershey Chocolate U.S.A. unveiled the most significant modernization project to date with the announcement of plans to construct a major new chocolate-processing facility in Hershey, Pa. The 130,000-square-foot facility will process chocolate to be used primarily by the main Hershey plant to manufacture confectionery products. The new facility's state-of-the-art production systems will replace older systems currently located in the main Hershey plant.

This effort is consistent with Hershey Chocolate U.S.A.'s attempt to lower manufacturing costs through modernization of facilities and through a program to foster a "can do" attitude toward productivity and quality on the part of all employees. Over the past four years, the Division has realized significant productivity savings which have been reinvested in the business while at the same time enhancing the Division's level of profitability.

Hershey Chocolate U.S.A. has benefited from relatively stable-to-lower net commodity costs. While the cost of milk and almonds increased during 1989, the cost of peanuts was stable, and the cost of cocoa beans declined significantly as world supply increased in the wake of the sixth consecutive surplus crop. Domestic sugar cost per pound increased slightly, continuing at levels much higher than world sugar prices due to federal government price supports.

Overall, Hershey Chocolate U.S.A. is well-positioned for the future. The Division is committed to providing superior quality and value in all its products — a commitment that has gained millions of loyal consumers.

Hershey Canada Inc.

Hershey Canada Inc. had a disappointing year as 1989 earnings were below the previous year due to generally lower sales for the Division's products. In the first half of the year, industry sales were sluggish because customers had accumulated inventories during December 1988 in anticipation of a January 1989 price increase. In the second half of the year, competitive pressures, as well as capacity constraints and manufacturing inefficiencies related to the startup of production lines relocated to Smiths Falls, Ontario, from the Sherbrooke, Quebec, plant, also hampered sales.

Despite the sales and customer service challenges of the past year, Hershey's franchise with Canadian consumers is healthy. Hershey Canada's share of market remained solid throughout the year. This provides a strong base for the future.

A major focus for the Canadian operation during the year was the consolidation of manufacturing operations at the Smiths Falls plant. This coincided with the closing of the Sherbrooke plant and the transfer of most of the production lines to Smiths Falls. This was the final step in the plant rationalization program implemented as a result of opportunities identified as part of the acquisition of the confectionery and snack nut businesses of Nabisco Brands Ltd. in June 1987. In addition to achieving sufficient size to have a meaningful market presence, the other factor motivating the purchase of

Christy Ricker and other Hershey Chocolate U.S.A. Customer Service Representatives rely on a sophisticated, computer-based system to provide customers with up-to-the-minute information regarding their orders. Maintaining excellent customer relations is vital to Hershey Foods' ability to market its expanding line of confectionery and pasta products.

LUDEN'S
HONEY LEMON
Handy 3 Pack
LUDEN'S WILD CHERRY
Almond Joy
Reese's
ROAST ALMOND
FRUIT & NUT
Caramello
HERSHEY'S
MILK CHOCOLATE
SKOR
6 PACK
HERSHEY'S ALMONDS
KitKat

these businesses was the significant manufacturing synergies available to the combined organizations. By closing and consolidating plants, the Division is positioned to reduce dramatically the cost of production and is, therefore, a more formidable competitor in the Canadian confectionery market which itself has undergone considerable rationalization and consolidation in recent years.

The manufacturing concentration at Smiths Falls also has created opportunities for distribution cost savings and improved customer service. Construction of a 110,000-square-foot distribution facility was completed during 1989 and is demonstrating expected distribution efficiencies. This will allow Hershey Canada to enter the new decade with a highly efficient confectionery and snack nut production and distribution complex.

As Hershey Canada enters the 1990s, a new management team has been formed to better meet the needs of its enlarged business. In addition to completing the plant rationalization program, the new management team is concentrating its efforts on building sales and improving customer service levels. This task will be aided by the improved information systems which have been installed to make the Division's sales and distribution network operate more efficiently.

The separation of Hershey Chocolate U.S.A.'s sales organization into two sales groups, one responsible for confectionery and the other for grocery products, provides a firm foundation for each category's future growth. Here, Sales Representative Mark Williams (right) consults with District Manager Dave Onorato at a supermarket.

Hershey Refrigerated Products

Hershey's chocolate bar flavor puddings are a new product entry which marks a significant departure from the traditional *Hershey's* product lines. Distribution of the refrigerated *Hershey's* puddings began in late 1989 to selected East Coast markets and was expanded to West Coast markets in January 1990. The puddings are the first new product concept to emerge from the Venture Group, recently formed within the Corporation to

pursue product concepts not in the mainstream of traditional Hershey businesses.

Sold in four flavors — *Hershey's* chocolate, *Hershey's* chocolate & almond, *Hershey's Kisses* chocolate & vanilla, and *York* peppermint pattie — the new puddings achieved exceptionally high consumer acceptance in conceptual testing.

Refrigerated, ready-to-eat puddings have shown explosive growth over recent years, and two-thirds of all dry and refrigerated puddings purchased are chocolate. The Corporation's entry into this category is predicated on Hershey's reputation as the premier chocolate company in the United States.

Hershey International

Hershey International had an excellent year in 1989, with export sales volume, export income and equity income significantly exceeding the prior year. The strong export results were led by sales to the Far East and Latin American regions.

South Korea and the Philippines accounted for most of the sales growth in the Far East. The Corporation's licensee in South Korea, Hai-Tai Confectionery Company, Ltd., was aggressive in marketing *Hershey's Kisses* chocolates and *Hershey's* chocolate chips, as well as locally-produced *Hershey's* licensed products. A large increase in sales to Mexico was the chief factor leading to a successful year in exports to the Latin American region. Mexico recently removed import restrictions on a broad range of products, including

confectionery items. Consumer response to *Hershey's* products exported to Mexico has been excellent.

AB Marabou, a Swedish company in which the Corporation holds an equity interest, was a major contributor to Hershey International's equity earnings during 1989. Marabou is the leading confectioner in Sweden and has a significant presence in the broader Scandinavian market with its confectionery, snack and biscuit product lines.

Hershey International's joint venture in Mexico, Nacional de Dulces S.A. de C.V., experienced strong demand for its locally-produced confectionery products, as well as for the imported *Hershey's* products.

Petybon S.A., the Corporation's Brazilian joint venture, performed as expected as strong consumer demand for pasta continued in this market.

In July 1989, the Corporation signed a joint venture agreement with Fujiya Co., Ltd. of Tokyo forming a new confectionery company, Hershey Japan Co., Ltd. Headquartered in Tokyo, the company will market, sell and distribute selected *Hershey's* confectionery products in the Japanese market. Prior to the new joint venture agreement, *Hershey's* products were positioned for sale in imported goods channels such as department stores and import shops. Under the new arrangement, certain *Hershey's* products will be marketed through a much broader distribution system and will be available to a larger segment of Japanese consumers. During the latter part of 1989, Hershey Japan personnel began to conduct market research to determine which *Hershey's* products best suit the Japanese market.

Hershey Pasta Group

Hershey Pasta Group achieved record sales and earnings during 1989. Sales dollar growth primarily was the result of selling price increases in the third quarter of 1988 in response to sharp increases in durum wheat semolina costs. These price increases, which occurred throughout the industry, resulted in a slowing of volume growth in

More than 3,000 Hershey Chocolate U.S.A., Corporate Staff, Hershey Pasta Group and Hershey International employees have taken part in "Quality Through Excellence" training since the program was initiated by Hershey Chocolate U.S.A. in 1986. Developed to encourage employee involvement, the Corporation's productivity programs have generated significant savings since 1986.

The consolidation of Hershey Canada's manufacturing operations picked up speed during 1989 as a number of manufacturing lines were transferred from another plant to its Smiths Falls, Ontario, facility. Line Operator Theresa Reil checks production quality of *Oh Henry!* candy bars, one of the leading brands in Canada.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the dry pasta category, particularly in the first half of 1989.

Hershey Pasta Group sales volumes were weak into the middle of the year. However, as durum wheat semolina costs declined in the second half of the year, the Division instituted selected price reductions and increased promotional spending levels. For the year, Hershey Pasta Group achieved volume growth in the retail category.

Hershey Pasta Group's volume gains in 1989 principally were in the *San Giorgio, Light 'N Fluffy,* and *American Beauty* brands. Each of these brands achieved share gains in their marketing areas. Through a combination of lower ingredient costs and stronger sales volume during the second half of 1989, the Division was able to achieve excellent earnings results for the entire year.

The Division continued its geographic expansion into the West and Midwest, as well as its rollout of new items such as *Trio Italiano* (rotini, shells and mostaccioli) and *Fettuccini Florentine* (a spinach and egg fettuccini combination). New products included Mafalda (a ripple-edged, mini lasagne-shaped item) and, most significantly, *Perfection* microwave pasta.

Hershey Pasta Group's *Perfection* microwave pasta currently is the most exciting new product concept in the pasta industry. It is the first dry pasta made specifically for microwave cooking to be introduced in the United States. Made from 100 percent durum wheat semolina, the product is pre-cooked and dried during production. The pre-cooking enables *Perfection* microwave pasta to cook quickly in a microwave oven, and the finished product is delicious pasta without the stickiness usually associated with regular pasta cooked in a microwave oven.

The technology which makes this high quality product possible was developed in Italy, and Hershey Pasta Group currently has an exclusive arrangement for the equipment with the supplier. Distribution of four popular varieties — elbows, spirals, rigatoni and mostaccioli — began in the Midwest in November.

The Division continues to improve productivity through a long-range program of plant modernization. During 1989, major new conventional pasta lines and related packaging systems were added in the Omaha, Neb., and Fresno, Calif., plants. Also, the line which manufactures *Perfection* microwave pasta was installed in the Kansas City, Kan., plant. Additional new line installations are scheduled during 1990.

A highlight during 1989 was the 75th anniversary of *San Giorgio,* one of the top five pasta brands in the United States. Established in 1914 by Girolamo Guerrisi, *San Giorgio* was acquired by Hershey Foods Corporation in 1966. It became the cornerstone upon which the Hershey Pasta Group was built. Its products are distributed primarily in the Middle Atlantic states, as well as in parts of New England and the Midwest.

New excitement came to the pasta industry in 1989 with Hershey Pasta Group's announcement of *Perfection* microwave pasta, the first pasta made exclusively for the microwave. Pasta Marketing Director Gary Lauerman samples a recipe with Senior Home Economist Cheryl Reitz in Hershey's microwave test kitchen.

The import situation continues to be a concern for U.S. pasta manufacturers. Italian pasta imports to the U.S. in 1989 were approximately 27 percent ahead of 1988 figures. Pasta imports from Turkey continue their strong growth and, in 1989, were approximately 40 percent ahead of the prior year.

Hershey Pasta Group's position was enhanced with the February 1990 acquisition of Ronzoni Foods Corporation from Kraft General Foods, Inc., a unit of Philip Morris Companies. The purchase included Ronzoni's dry pasta, pasta sauces and cheese businesses. *Ronzoni* is a major brand in the metropolitan New York area, the largest pasta consumption area in the United States. The addition of *Ronzoni* to Hershey Pasta Group should provide additional economies of scale which will benefit both businesses. ■


MICROWAVE PASTA
SPIRALS

MANAGEMENT'S DISCUSSION AND ANALYSIS – FINANCIAL REVIEW (Unaudited)

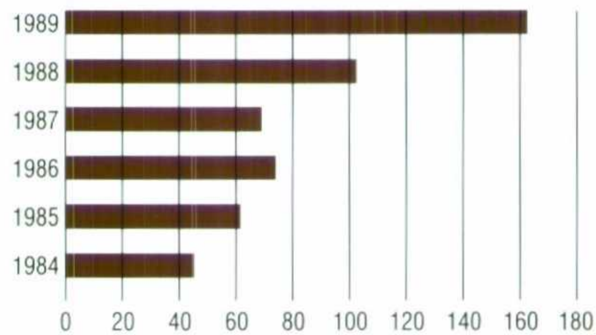
Summary of Consolidated Operating Results
The Corporation realized strong sales and earnings growth in 1989 and 1988. Net sales during this period increased at a compound annual rate of 14%, primarily reflecting unit volume growth from business acquisitions, existing brands and new product introductions. Higher selling prices for pasta products also had a slight impact on consolidated results during the period. Income from continuing operations increased at a compound annual rate of 17% due to growth in sales, an improved gross margin and a lower effective income tax rate, partially offset by higher levels of selling, marketing and administrative expenses.

Summary of Financial Position and Liquidity
The Corporation strengthened its financial position in 1989 as compared to 1988. The ratio of current assets to current liabilities was 2.0 : 1 at December 31, 1989 and 1.8 : 1 at December 31, 1988. The Corporation's capitalization ratio (total short-term and long-term debt as a percent of stockholders' equity, short-term and long-term debt) was 17% at December 31, 1989, and 22% at December 31, 1988.

During 1989, the Corporation's cash and cash equivalents decreased by $17.6 million. Cash provided from operations, in addition to cash and cash equivalents at the beginning of the period, was used primarily to finance capital additions, pay cash dividends and meet scheduled repayments of debt.

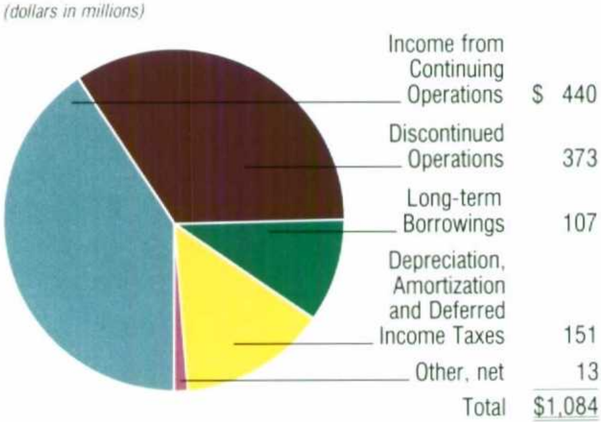
During the three-year period ended December 31, 1989, the Corporation's net cash position increased by $33.3 million. Total debt increased by $42.1 million, due in part to debt assumed in conjunction with business acquisitions. During this period the Corporation invested heavily in business acquisitions and capital additions.

CAPITAL ADDITIONS
(dollars in millions)

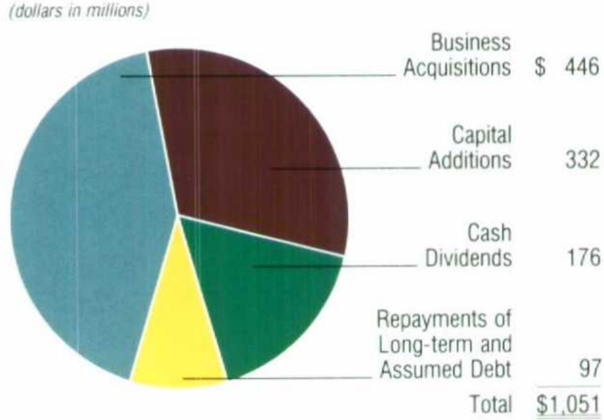


At December 31, 1989, the Corporation's principal capital commitments related to the construction of new facilities and the acquisition of Ronzoni Foods Corporation (Ronzoni) discussed below. The Corporation plans to begin construction of a modern chocolate-processing facility in Hershey in 1990. The new facility is expected to cost in excess of $100 million. The Corporation also has begun construction of new Corporate headquarters and data processing facilities on a site in Hershey. The Corporation

PRINCIPAL SOURCES OF CASH
1987 – 1989
(dollars in millions)



PRINCIPAL USES OF CASH
1987 – 1989
(dollars in millions)



anticipates a significant increase in capital additions over the next several years as a result of modernization of existing facilities and the installation of new manufacturing equipment, as well as construction of the new facilities referred to above. The aggressive capital addition program planned for the coming years, combined with the acquisition of Ronzoni, may necessitate incremental long-term financing.

Acquisitions and Divestitures

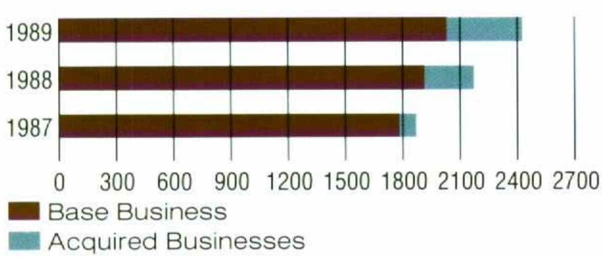
Operating results during the period were impacted by the following acquisitions:

- August 1988 — Acquired from Cadbury Schweppes Inc. and Cadbury Schweppes plc (Cadbury) the operating assets of Cadbury's U.S. confectionery business (Peter Paul/Cadbury) and entered into trademark and technology license agreements under which the Corporation manufactures and/or markets and distributes Cadbury's confectionery brands in the United States. The Corporation also has the right to manufacture, market and distribute certain brands outside of the United States; and
- June 1987 — Acquired the assets and trademark rights of Nabisco Brands Ltd.'s Canadian confectionery and snack nut businesses (Canadian Confectionery Operation).

A further discussion of these acquisitions can be found in Note 2 to the consolidated financial statements.

CONTRIBUTION TO NET SALES OF BUSINESSES ACQUIRED 1987–1989

(dollars in millions)



In February 1990, the Corporation purchased all of the outstanding voting securities of Ronzoni from Kraft General Foods, Inc. for approximately $80 million. The purchase included Ronzoni's dry pasta, pasta sauces and cheese businesses. Ronzoni had sales of approximately $85 million in 1989. The acquisition will not have a material effect on the Corporation's net sales and net income.

In September 1988, the Corporation sold all of the issued and outstanding capital stock of Friendly Ice Cream Corporation (Friendly). A further discussion of the sale of Friendly can be found in Note 3 to the consolidated financial statements.

Other Items

The most significant raw material used in the production of the Corporation's chocolate and confectionery products is cocoa beans. Generally, the Corporation has been able to offset the effects of increases in the cost of this raw material through selling price increases or reductions in product weights. Conversely, declines in the cost of cocoa beans have served as a source of funds to enhance consumer value, respond to competitive activity, develop new products and markets, and offset rising costs of other raw materials and expenses.

The cost of cocoa beans and the prices for the related commodities futures historically have been subject to wide fluctuations attributable to a variety of factors, including the effect of weather on crop yield, other imbalances between supply and demand, and speculative influences. During 1988 and 1989 the market price of cocoa beans and cocoa futures declined as a result of a worldwide excess supply. The oversupply situation is expected to continue into 1990 and is anticipated to have a favorable impact on the Corporation's cocoa bean cost. The favorable impact will not necessarily be consistent with quoted market prices because of the Corporation's forward purchasing practices, premiums and discounts reflective of relative values, varying delivery times, and supply and demand for specific varieties and grades of cocoa beans.

In January 1990, Freia AS (Freia), a Norwegian confectionery company and major shareholder of AB Marabou (Marabou), announced plans to tender for those shares of Marabou that it does not currently own. Marabou

shareholders tendering their holdings may receive either cash or Freia stock. The Corporation owns approximately 17% of the outstanding stock of Marabou and, because of different voting rights between the classes of the stock, has 20% of the total shareholder votes. The Corporation has not decided on its course of action.

Effects of Inflation

The Corporation monitors the effects of inflation and takes various steps, including selling price and product weight changes, to minimize its impact on the Corporation's business. The use of LIFO inventory accounting for most inventories matches current costs with current revenues and, in periods of inflation, reduces income taxes and improves cash flow. The capital additions program, through investment in modern plant and equipment, provides for future sales growth and manufacturing efficiencies. This approach to management of inflation, the generally stable-to-lower costs of major commodities and other manufacturing materials, and the modest rate of inflation on most other costs as measured by the Consumer Price Index, are the principal factors which have resulted in inflation having a minimal effect on comparative results of operations and financial condition for the most recent three years.

Capital Structure

The Corporation has two classes of stock outstanding, Common Stock and Class B Common Stock (Class B Stock). The Common Stock and the Class B Stock generally vote together without regard to class on matters submitted to stockholders, including the election of directors, with the Common Stock having one vote per share and the Class B Stock having ten votes per share. However, the Common Stock, voting separately as a class, is entitled to elect one-sixth of the Board of Directors. With respect to dividend rights, the Common Stock is entitled to cash dividends 10% higher than those declared and paid on the Class B Stock.

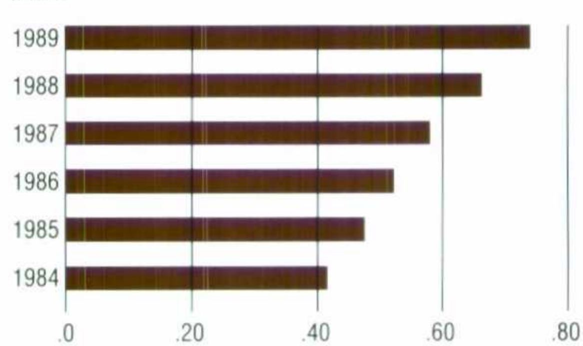
Securities and Exchange Commission (SEC) Rule 19c-4 (Rule), concerning dual classes of stock, provides that no equity security of any issuer can be listed on a securities exchange or national market system if the company issues any class of stock or takes any corporate action that has the effect of nullifying, restricting or disparately reducing the per share voting rights of any class of common stock outstanding. The Corporation's capital structure was grandfathered under this Rule and it will not affect the Corporation's ability to issue Common Stock in the future. On September 2, 1988, the Business Roundtable filed suit in the U.S. Court of Appeals for the District of Columbia challenging the SEC's authority to promulgate the Rule. The case has been argued and a decision is expected in the first half of 1990. If the Business Roundtable is successful, the Rule would be invalidated in whole or in part. The Rule remains in force pending the outcome of the Business Roundtable suit. On January 3, 1990, the substance of Rule 19c-4 was adopted as a rule of the New York Stock Exchange, including provision for grandfathering the Corporation's and other dual class structures.

Market Prices and Dividends

Cash dividends paid on the Corporation's Common Stock and Class B Stock were $65.6 million in 1989 and $58.5 million in 1988. The annual dividend rate on the Common Stock is $.78 per share, an increase of 11% over the 1988 rate of $.70 per share. The 1989 dividend represents the 15th consecutive year of Common Stock dividend increases.

DIVIDENDS PAID PER SHARE OF COMMON STOCK

(dollars)



On February 7, 1990, the Corporation declared a regular quarterly dividend of $.195 per share of the Common Stock payable on March 15, 1990, to stockholders of record February 26, 1990. It is the Corporation's 241st consecutive regular Common Stock dividend. A regular quarterly dividend of $.175 per share of the Class B Stock also was declared.

Hershey Foods Corporation Common Stock is listed and traded principally on the New York Stock Exchange under the ticker symbol "HSY." Approximately 41.2 million shares of the Corporation's Common Stock were traded during 1989. The closing price of the Common Stock on the New York Stock Exchange (NYSE) at December 31, 1989 was $35⅞. The Class B Stock is not publicly traded. There were 29,998 stockholders of record of the Common Stock and the Class B Stock at December 31, 1989.

The following table shows the dividends paid per share of Common Stock and Class B Stock and the price range of the Common Stock for each quarter of the past two years:

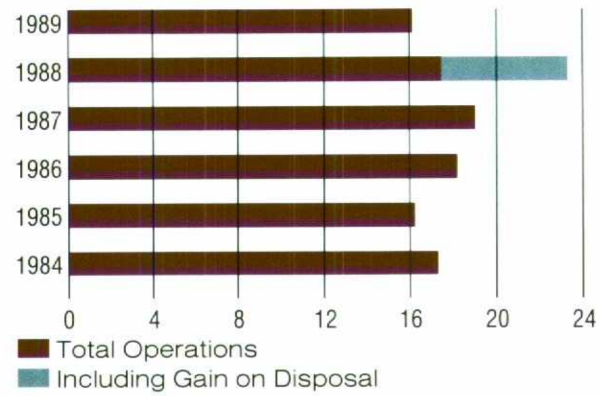
	Dividends Paid Per Share		Common Stock Price Range*	
	Common Stock	Class B Stock	High	Low
1989				
1st Quarter	**$.1750**	**$.1575**	**$27¼**	**$24¾**
2nd Quarter	**.1750**	**.1575**	**34**	**26**
3rd Quarter	**.1950**	**.1750**	**35½**	**31¼**
4th Quarter	**.1950**	**.1750**	**36⅞**	**31¼**
	$.7400	**$.6650**		
1988				
1st Quarter	$.1550	$.1400	$28⅜	$22⅞
2nd Quarter	.1550	.1400	26¼	21⅞
3rd Quarter	.1750	.1575	25½	22⅞
4th Quarter	.1750	.1575	28⅝	24⅜
	$.6600	$.5950		

* NYSE-Composite Quotations for Common Stock by calendar quarter

Operating Return on Average Stockholders' Equity

The Corporation's operating return on average stockholders' equity over the most recent six-year period has ranged from 16.1% in 1989 to 19.0% in 1987. Operating return on average stockholders' equity declined in both 1989 and 1988. These declines were partially attributable to higher stockholders' equity resulting from the gain on the sale of Friendly.

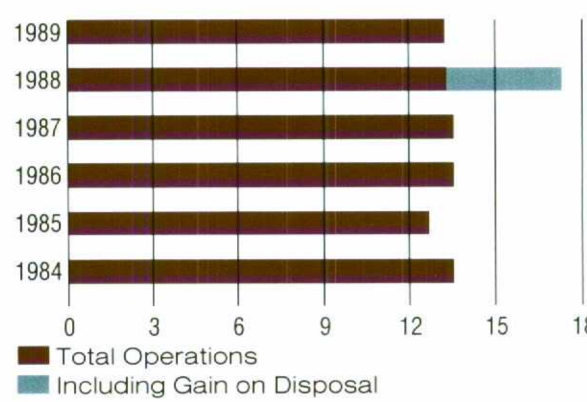
RETURN ON AVERAGE STOCKHOLDERS' EQUITY
(percent)



Operating Return on Average Invested Capital

The Corporation's operating return on average invested capital over the most recent six-year period has ranged from 12.7% in 1985 to 13.5% in 1984. Average invested capital consists of the annual average of beginning and ending balances in long-term debt, deferred income taxes and stockholders' equity. Earnings on invested capital is the sum of net income, excluding gain on disposal of discontinued operations, plus the after-tax effect of interest on long-term debt.

RETURN ON AVERAGE INVESTED CAPITAL
(percent)



CONSOLIDATED STATEMENTS OF INCOME

(in thousands of dollars except per share amounts)

For the years ended December 31,	1989	1988	1987
Net Sales	**$2,420,988**	$2,168,048	$1,863,816
Costs and Expenses:			
Cost of sales	**1,455,612**	1,326,458	1,149,663
Selling, marketing and administrative	**655,040**	575,515	468,062
Total costs and expenses	**2,110,652**	1,901,973	1,617,725
Income from Continuing Operations before Interest and Income Taxes	**310,336**	266,075	246,091
Interest expense, net	**20,414**	29,954	22,413
Income from Continuing Operations before Income Taxes	**289,922**	236,121	223,678
Provision for income taxes	**118,868**	91,615	99,604
Income from Continuing Operations	**171,054**	144,506	124,074
Discontinued Operations	**—**	69,443	24,097
Net Income	**$ 171,054**	$ 213,949	$ 148,171
Income per Share:			
Continuing Operations	**$ 1.90**	$ 1.60	$ 1.38
Discontinued Operations	**—**	.77	.26
Net Income	**$ 1.90**	$ 2.37	$ 1.64

Cash Dividends Paid per Share:			
Common Stock	**$ .740**	$ .660	$ .580
Class B Common Stock	**.665**	.595	.525
Income from Continuing Operations before Interest and Income Taxes as a Percent of Net Sales	**12.8%**	12.3%	13.2%
Income from Continuing Operations as a Percent of Net Sales	**7.1%**	6.7%	6.7%

The notes to consolidated financial statements are an integral part of these statements.

Management's Discussion and Analysis – Results of Continuing Operations (Unaudited)

Net Sales
Net sales rose $252.9 million or 12% in 1989 and $304.2 million or 16% in 1988. The sales increases in both years reflected unit volume growth from a combination of acquisitions, established brands and new product introductions. The favorable sales performance was partly enhanced in 1989 and 1988 by higher selling prices for pasta products, which were required in order to cover escalating durum wheat costs resulting from the severe drought experienced by wheat growers during 1988.

Costs and Expenses
Cost of sales as a percent of net sales declined from 61.7% in 1987 to 61.2% in 1988 and 60.1% in 1989. The decrease in 1988 reflects changes in the Corporation's sales mix and relatively stable raw material costs, although durum wheat costs increased dramatically due to the drought in that year. The further reduction in 1989 was due to a decline in overall raw material costs resulting from lower cocoa bean prices plus manufacturing efficiencies, partially offset by an increase in the average cost per pound of milk, sugar and durum wheat.

Selling, marketing and administrative expenses rose as a percent of net sales from 25.1% in 1987 to 26.5% in 1988 and 27.1% in 1989. Increases in selling and marketing expenses primarily reflect higher expenditures and incremental programs in support of acquired and existing brands, as well as new product introductions. General and administrative expenses were relatively stable as a percent of net sales during the period.

Interest Expense, Net
Net interest expense was $9.5 million lower in 1989 compared to 1988, primarily due to a reduction in seasonal short-term borrowings and higher capitalized interest resulting from increased capital spending. Net interest expense increased by $7.5 million in 1988 as a result of debt issued in 1987 and higher levels of short-term borrowings during 1988 to meet seasonal working capital requirements. The debt issuances in 1987 related principally to business acquisitions.

Provision for Income Taxes
The Tax Reform Act of 1986 reduced the Federal statutory corporate income tax rate from 40% in 1987 to 34% in 1988 and subsequent years. As a result, the Corporation's effective income tax rate on income from continuing operations decreased from 44.5% in 1987 to 38.8% in 1988. During 1989, the effective tax rate increased to 41.0%, principally as a result of a change in the mix of the Corporation's income among various tax jurisdictions and higher nondeductible acquisition costs.

Income from Continuing Operations
Income from continuing operations increased $26.5 million or 18% in 1989, following a $20.4 million or 16% increase in 1988. Income from continuing operations as a percent of net sales (continuing operations margin) was 7.1% in 1989 and 6.7% in both 1988 and 1987. The Corporation's continuing operations margin has not increased at the same rate as the gross margin due to expanded and incremental selling and marketing programs.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands of dollars)

For the years ended December 31,	1989	1988	1987
Cash Flows Provided from (Used by) Operating Activities			
Income from continuing operations	$ 171,054	$ 144,506	$ 124,074
Adjustments to reconcile income from continuing operations to net cash provided from continuing operations:			
Depreciation and amortization	65,729	51,897	40,389
Deferred income taxes	3,369	4,884	(15,346)
Changes in assets and liabilities, net of effects from business acquisitions:			
Accounts receivable—trade	44,846	(18,207)	(44,148)
Inventories	(1,082)	6,250	(20,536)
Accounts payable	(26,546)	7,514	27,386
Other assets and liabilities	3,080	1,953	16,104
Other, net	5,195	1,899	941
Net cash provided from continuing operations	265,645	200,696	128,864
Net cash provided from discontinued operations	—	6,187	22,718
Net Cash Provided from Operating Activities	265,645	206,883	151,582
Cash Flows Provided from (Used by) Investing Activities			
Capital additions	(162,032)	(101,682)	(68,504)
Business acquisitions	—	(284,540)	(161,610)
Sale of Friendly Ice Cream Corporation	—	375,000	—
Tax effect of gain on sale of Friendly Ice Cream Corporation	—	(30,821)	—
Other, net	(2,316)	8,882	3,046
Net Cash (Used by) Investing Activities	(164,348)	(33,161)	(227,068)
Cash Flows Provided from (Used by) Financing Activities			
Net increase (decrease) in short-term debt	—	(25,463)	25,463
Long-term borrowings	1,794	713	104,338
Repayment of long-term debt	(55,105)	(4,769)	(14,244)
Repayment of assumed debt	—	(23,371)	—
Cash dividends paid	(65,592)	(58,530)	(51,467)
Net Cash Provided from (Used by) Financing Activities	(118,903)	(111,420)	64,090
Increase (Decrease) in Cash and Cash Equivalents	(17,606)	62,302	(11,396)
Cash and Cash Equivalents at January 1	70,073	7,771	19,167
Cash and Cash Equivalents at December 31	$ 52,467	$ 70,073	$ 7,771

Interest Paid (Continuing Operations)	$ 21,329	$ 29,555	$ 20,493
Income Taxes Paid (Continuing Operations)	$ 106,218	$ 84,902	$ 108,613

The notes to consolidated financial statements are an integral part of these statements.

MANAGEMENT'S DISCUSSION AND ANALYSIS – CASH FLOWS (Unaudited)

In 1988, the Corporation adopted the provisions of Statement of Financial Accounting Standards No. 95, "Statement of Cash Flows" (FAS No. 95), and restated the previously reported statement of changes in financial position for 1987. During 1989, the Financial Accounting Standards Board amended the provisions of FAS No. 95 as they relate to classification of cash flows from hedging activities. As a result of this amendment, cash flows from commodities hedging activities have been classified as operating activities for all years presented. As required by FAS No. 95 prior to this amendment, hedging activities had previously been classified as investing activities.

Operating Activities

Operating activities include both continuing and discontinued operations. Depreciation and amortization have increased significantly as a result of continuous investment in capital additions and business acquisitions. Cash requirements for accounts receivable and inventories have tended to fluctuate during the three-year period based on sales during December and inventory management practices. During the past three years, cash provided from continuing operations was $595.2 million and has exceeded cash requirements for capital additions and dividend payments during that period by $87.4 million.

The Corporation's cash provided from continuing operations during the year is affected by seasonal sales patterns. Chocolate and confectionery seasonal and holiday related sales are typically highest during the third and fourth quarters of the year, representing the principal seasonal effect. Generally, the Corporation's seasonal working capital needs peak during the summer months.

Cash provided from discontinued operations reflects income from discontinued operations, adjusted for changes in net assets of discontinued operations.

Investing Activities

Investing activities reflect capital additions, business acquisitions and, in 1988, the disposition of Friendly. Capital additions during the past three years included manufacturing equipment, expansion of existing facilities and construction of new facilities. Cash used for business acquisitions reflects current assets, property, plant and equipment and intangibles acquired, net of liabilities assumed. Businesses acquired during the past three years include Peter Paul/Cadbury in 1988 and the Canadian Confectionery Operation in 1987. The gross proceeds from the disposition of Friendly were reduced by income taxes on the gain on the sale.

Financing Activities

Financing activities include debt borrowings and repayments, and the payment of dividends. In each of the past three years, domestic short-term borrowings in the form of commercial paper or short-term commercial bank borrowings were required to fund seasonal working capital requirements. In November 1989, $50.0 million of notes were repaid as they matured. In 1988, the cash proceeds from the sale of Friendly were used to repay short-term borrowings required to finance the Peter Paul/Cadbury acquisition, debt assumed as part of the acquisition, and short-term seasonal borrowings. In 1987, the increase in short-term debt and the long-term borrowings primarily reflected the financing of the Canadian Confectionery Operation acquisition.

Cash dividends increased 12% in 1989 over 1988 and 14% in 1988 over 1987. Dividends paid to stockholders totaled $175.6 million over the three-year period. This represents an average of 28% of cash provided from operating activities.

CONSOLIDATED BALANCE SHEETS

(in thousands of dollars)

December 31,	1989	1988
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 52,467	$ 70,073
Accounts receivable — trade	121,943	166,789
Inventories	309,837	308,755
Prepaid expenses and other	83,322	73,480
Total current assets	567,569	619,097
Property, Plant and Equipment, Net	829,905	736,012
Intangibles Resulting from Business Acquisitions	373,396	371,286
Investments and Other Assets	43,231	38,270
	$1,814,101	$1,764,665
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	$ 102,240	$ 128,786
Accrued liabilities	142,856	144,326
Accrued income taxes	22,094	17,394
Current portion of long-term debt	18,558	54,875
Total current liabilities	285,748	345,381
Long-term Debt	216,108	233,025
Other Long-term Liabilities	53,667	47,964
Deferred Income Taxes	141,528	132,429
Total liabilities	697,051	758,799
Stockholders' Equity:		
Common Stock, 74,907,032 shares outstanding	74,907	74,907
Class B Common Stock, 15,279,304 shares outstanding	15,279	15,279
Additional paid-in capital	50,212	50,779
Cumulative foreign currency translation adjustments	26,870	20,581
Retained earnings	949,782	844,320
Total stockholders' equity	1,117,050	1,005,866
	$1,814,101	$1,764,665

The notes to consolidated financial statements are an integral part of these balance sheets.

Management's Discussion and Analysis – Financial Condition (Unaudited)

Assets

Total assets increased $49.4 million or 3% at December 31, 1989, primarily due to capital additions, partially offset by depreciation and a decrease in trade accounts receivable.

Current assets decreased $51.5 million at December 31, 1989, reflecting lower trade accounts receivable and cash and cash equivalents. The decrease in trade accounts receivable reflects lower sales in December 1989 compared with strong sales of confectionery and pasta products in December 1988. The lower cash balance at December 31, 1989, primarily reflects reduced short-term investments.

Capital additions totaled $162.0 million in 1989, while depreciation expense amounted to $54.5 million. Property, plant and equipment retirements included the disposal of certain assets acquired through business acquisitions in 1988 and 1987.

The increase in intangibles resulting from business acquisitions at December 31, 1989, primarily reflects a revision of the preliminary estimates of the fair value of certain tangible assets acquired as part of the Peter Paul/Cadbury acquisition.

Liabilities

Total liabilities decreased $61.7 million or 8% at December 31, 1989, primarily due to decreases in the current portion of long-term debt, accounts payable, and long-term debt.

Total debt decreased $53.2 million at December 31, 1989. The decrease in current portion of long-term debt at December 31, 1989, reflects the repayment in November 1989 of $50.0 million of notes issued in 1986. Bank lines of credit, which may be borrowed directly or used to support the issuance of commercial paper, totaled $100 million at December 31, 1989. The Corporation had no short-term borrowings at December 31, 1989 and 1988.

The $26.5 million decrease in accounts payable reflects reduced deliveries of certain raw materials and packaging materials in December 1989 compared with December 1988.

Total taxes payable, consisting of accrued income taxes and deferred income taxes, rose $13.8 million in 1989, primarily reflecting higher income from continuing operations.

The deferred income tax liability at December 31, 1989 and 1988 has been provided based on statutory corporate income tax rates in effect at the time of the underlying transactions. The Financial Accounting Standards Board has issued Statement of Financial Accounting Standards No. 96, "Accounting for Income Taxes" (FAS No. 96). Among other changes, FAS No. 96 provides for recording deferred income taxes at tax rates in effect when temporary differences are expected to reverse, and adjustment of deferred income tax balances when statutory corporate income tax rates are increased or reduced. Upon adoption, the Corporation has the option to record the entire adjustment in the year of adoption or retroactively restate prior years.

Adoption of FAS No. 96 is required no later than 1992, although earlier implementation is permitted. The Corporation has not decided in which year it will implement the change, nor has it decided which option it will utilize. However, management believes that based on the current Federal statutory corporate income tax rate, either method, when adopted, will have a favorable impact on net income.

Stockholders' Equity

Total stockholders' equity rose 11% in 1989 and has increased at a compound growth rate of 11% over the past five years.

Cumulative foreign currency translation adjustments increased at December 31, 1989, reflecting continuing appreciation of the Canadian dollar. The Canadian dollar has strengthened from approximately $.838 U.S. at the end of 1988 to approximately $.864 U.S. at year-end 1989.

HERSHEY FOODS CORPORATION

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(in thousands of dollars)

	Common Stock	Class B Common Stock	Additional Paid-In Capital	Cumulative Foreign Currency Translation Adjustments	Retained Earnings	Total Stockholders' Equity
Balance at January 1, 1987	$74,886	$15,300	$51,681	$ (6,123)	$592,197	$ 727,941
Net income					148,171	148,171
Dividends—Common Stock and Class B Common Stock					(51,467)	(51,467)
Foreign currency translation adjustments				8,161		8,161
Conversion of Class B Common Stock into Common Stock	3	(3)				—
Incentive plan transactions			(396)			(396)
Balance at December 31, 1987	74,889	15,297	51,285	2,038	688,901	832,410
Net income					213,949	213,949
Dividends—Common Stock and Class B Common Stock					(58,530)	(58,530)
Foreign currency translation adjustments				18,543		18,543
Conversion of Class B Common Stock into Common Stock	18	(18)				—
Incentive plan transactions			(506)			(506)
Balance at December 31, 1988	74,907	15,279	50,779	20,581	844,320	1,005,866
Net income					171,054	171,054
Dividends—Common Stock and Class B Common Stock					(65,592)	(65,592)
Foreign currency translation adjustments				6,289		6,289
Incentive plan transactions			(567)			(567)
Balance at December 31, 1989	**$74,907**	**$15,279**	**$50,212**	**$26,870**	**$949,782**	**$1,117,050**

The notes to consolidated financial statements are an integral part of these statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

Significant accounting policies employed by the Corporation are discussed below and in Notes 8, 9, 10, 11 and 12.

During 1989, the Financial Accounting Standards Board amended the provisions of Statement of Financial Accounting Standards No. 95, "Statement of Cash Flows" (FAS No. 95) as they relate to classification of cash flows from hedging activities. As a result of this amendment, cash flows from commodities hedging activities have been classified as operating activities for all years presented. As required by FAS No. 95 prior to this amendment, hedging activities had previously been classified as investing activities.

Principles of Consolidation
The consolidated financial statements include the accounts of the Corporation and its subsidiaries after elimination of intercompany accounts and transactions. Investments in affiliated companies are accounted for on the equity method.

Cash Equivalents
All highly liquid debt instruments purchased with a maturity of three months or less are classified as cash equivalents.

Commodities Futures Contracts and Options
In connection with the purchasing of major commodities (principally cocoa and sugar) for anticipated manufacturing requirements, the Corporation enters into commodities futures contracts and options as deemed appropriate to reduce the risk of future price increases. These futures contracts and options are accounted for as hedges and, accordingly, gains and losses are deferred and recognized in cost of sales as part of the product cost.

Property, Plant and Equipment
Property, plant and equipment are stated at cost. Depreciation of buildings and machinery and equipment is computed using the straight-line method over the estimated useful lives.

Intangibles Resulting from Business Acquisitions
Intangible assets resulting from business acquisitions principally consist of the excess of the acquisition cost over the fair value of the net assets of businesses acquired (goodwill). Goodwill is amortized on a straight-line basis over 40 years. Other intangible assets are amortized on a straight-line basis over their estimated useful lives.

Accumulated amortization of intangible assets resulting from business acquisitions was $25.7 million and $14.8 million at December 31, 1989 and 1988, respectively.

Foreign Currency Translation
Results of operations for foreign entities are translated using the average exchange rates during the period. For foreign entities operating in non-highly inflationary economies, assets and liabilities are translated to U.S. dollars using the exchange rates in effect at the balance sheet date. Resulting translation adjustments are recorded in a separate component of stockholders' equity, "Cumulative Foreign Currency Translation Adjustments."

License Agreements
The Corporation has entered into licensing agreements under which it has access to proprietary technology and manufactures and/or markets and distributes certain products. The Corporation's rights under these agreements are extendable on a long-term basis at the Corporation's option subject to certain conditions, including minimum sales levels. License fees and royalties, payable under the terms of the agreements, are expensed as incurred.

2. Acquisitions

On August 25, 1988, the Corporation acquired from Cadbury Schweppes Inc. and Cadbury Schweppes plc (Cadbury) certain assets and liabilities of Cadbury's U.S. confectionery business (Peter Paul/Cadbury) for $284.5 million, plus the assumption of $30.0 million in debt. In addition, the parties entered into trademark and technology license agreements under which the Corporation manufactures and/or markets and distributes Cadbury's confectionery brands in the United States. The Corporation also has the right to manufacture, market and distribute certain brands outside of the United States.

In June 1987, the Corporation acquired the assets and trademark rights of Nabisco Brands Ltd.'s Canadian confectionery and snack nut businesses (Canadian Confectionery Operation) for $161.6 million. The Corporation also assumed certain long-term debt.

The above acquisitions were accounted for as purchases and, accordingly, results subsequent to the dates of acquisition are included in the consolidated financial statements. Had the acquisition of Peter Paul/Cadbury occurred at the beginning of each period and the Canadian Confectionery Operation occurred at the beginning of 1987, pro forma consolidated results would have been as follows:

For the years ended December 31,	1988	1987
(in thousands of dollars except per share amounts)	*(unaudited)*	
Net sales	$2,311,085	$2,208,691
Income from continuing operations	129,689	104,019
Net income	199,132	128,116
Income from continuing operations per share	1.44	1.15
Net income per share	2.21	1.42

The pro forma results are based on historical financial information provided by Cadbury and Nabisco Brands Ltd., as adjusted to give effect to certain costs and expenses, interest expense and income taxes which would have been incurred by the Corporation if it had owned and operated Peter Paul/Cadbury and the Canadian Confectionery Operation throughout the periods presented. These results are not necessarily reflective of the actual results which would have occurred if the acquisitions had been completed at the beginning of each year, nor are they necessarily indicative of future combined financial results.

The following table presents the fair value of the tangible and intangible assets acquired and the liabilities assumed in each year presented:

For the years ended December 31,	1988	1987
(in thousands of dollars)		
Assets acquired	$356,565	$174,339
Liabilities assumed, including debt	(72,025)	(12,729)
Cash paid	$284,540	$161,610

3. Divestitures

On September 2, 1988, the Corporation sold all of the issued and outstanding capital stock of Friendly Ice Cream Corporation (Friendly), a wholly-owned subsidiary of the Corporation. The total amount received for said securities, a covenant not to compete and a trademark license was $375.0 million. The sale of Friendly resulted in a gain of $53.4 million, net of income taxes of $30.8 million, or $.59 per share. Net sales for Friendly were $393.2 million and $572.4 million for the eight months in 1988 and the 1987 year, respectively. Income from discontinued operations was $16.0 million, net of income taxes of $11.2 million, or $.18 per share for the eight months in 1988 and $24.1 million, net of income taxes of $21.6 million, or $.26 per share for the 1987 year.

4. Capital Stock and Income Per Share

As of December 31, 1989, the Corporation had 530,000,000 authorized shares of capital stock. Of this total, 450,000,000 shares were designated as Common Stock, 75,000,000 shares as Class B Common Stock (Class B Stock), and 5,000,000 shares as Preferred Stock, each class having a par value of one dollar per share.

The Common Stock and the Class B Stock generally vote together without regard to class on matters submitted to stockholders, including the election of directors, with the Common Stock having one vote per share and the Class B Stock having ten votes per share. However, the Common Stock, voting separately as a class, is entitled to elect one-sixth of the Board of Directors. With respect to dividend rights, the Common Stock is entitled to cash dividends 10% higher than those declared and paid on the Class B Stock.

Class B Stock can be converted into Common Stock on a share-for-share basis at any time. There were no conversions of Class B Stock into Common Stock during 1989. During 1988, 17,582 shares of Class B Stock were converted into Common Stock. During 1987, 3,000 shares of Class B Stock were converted into Common Stock. At December 31, 1989, there was a combined total of 90,186,336 shares of both classes outstanding. No shares of the Preferred Stock were issued or outstanding.

Hershey Trust Company, as Trustee for Milton Hershey School (Hershey Trust), as institutional fiduciary for estates and trusts unrelated to Milton Hershey School, and as direct owner of investment shares, held a total of 23,407,835 shares of the Common Stock, and, as Trustee for Milton Hershey School, held 15,153,003 shares of the Class B Stock at December 31, 1989, and is entitled to cast approximately 77% of the total votes of both classes of the Corporation's common stock. Hershey Trust's approval is required prior to the issuance of shares of Common Stock or other action which would result in Hershey Trust not continuing to have voting control of the Corporation.

Income per share has been computed based on the weighted average number of shares of the Common Stock and the Class B Stock outstanding during the year (90,186,336 for all years presented).

5. Interest Expense

Interest expense, net consisted of the following:

For the years ended December 31,	**1989**	1988	1987
(in thousands of dollars)			
Long-term debt	**$27,492**	$27,288	$21,566
Short-term debt	**2,610**	8,093	3,436
Capitalized interest	**(6,594)**	(3,318)	(1,720)
	23,508	32,063	23,282
Interest income	**(3,094)**	(2,109)	(869)
Interest expense, net	**$20,414**	$29,954	$22,413

6. Short-term Debt

The Corporation maintained lines of credit arrangements with commercial banks, under which it could borrow up to $100 million at December 31, 1989 and 1988 at the lending banks' prime commercial interest rates or lower. These lines of credit, which may be used to support commercial paper borrowings, may be terminated at the option of the banks or the Corporation. There were no borrowings under these lines of credit or outstanding commercial paper borrowings at December 31, 1989 and 1988.

Lines of credit are supported by commitment fee arrangements. The fees range up to 3/8% per annum of the commitment. There were no compensating balance agreements which legally restrict these funds.

As a result of maintaining a consolidated cash management system, the Corporation maintains overdraft positions at certain banks. Such overdrafts, which are included in accounts payable, were $19.1 million and $28.9 million at December 31, 1989 and 1988, respectively.

7. Long-term Debt

Long-term debt consisted of the following:

December 31,	1989	1988
(in thousands of dollars)		
8.7% Senior Notes due 1989–1992	**$ 6,000**	$ 8,000
7.0% Notes due 1989	**—**	50,000
Medium-Term Notes, 8.45% to 9.92% (average rate 9.13%), due 1990–1998	**100,000**	100,000
7.25% Sinking Fund Debentures due 1997	**1,023**	1,023
9.5% Sinking Fund Debentures due 2009	**55,500**	56,250
9.125% Sinking Fund Debentures due 2016	**50,000**	50,000
Other obligations, net of unamortized debt discount	**22,143**	22,627
	234,666	287,900
Less—current portion	**18,558**	54,875
Total long-term debt	**$216,108**	$233,025

Aggregate annual maturities and sinking fund requirements during the next five years, net of repurchased debentures, are: 1990, $18.6 million; 1991, $22.4 million; 1992, $25.3 million; 1993, $7.8 million; and 1994, $14.8 million.

8. Income Taxes

The provision for income taxes is based on income from continuing operations before income taxes as reported in the consolidated statements of income. Income taxes relating to discontinued operations are included in "Discontinued Operations" in the consolidated statements of income. Tax credits are recognized as a reduction in the provision using the flow-through method.

Deferred income taxes are provided to reflect timing differences between reported results of operations for financial statement and income tax purposes. Timing differences relate primarily to accelerated depreciation, commodities futures contracts and employee benefit plan contributions. In 1987, the Corporation modified its tax treatment of certain insurance, marketing and employee benefit expenses. While these expenses continue to be recognized currently for financial statement purposes, the Corporation now deducts such amounts for income tax purposes when paid. This change necessitated a cumulative adjustment which increased the current provision for income taxes with an offsetting decrease in the deferred provision in 1987. The provision for income taxes on income from continuing operations was as follows:

For the years ended December 31,	1989	1988	1987
(in thousands of dollars)			
Current	**$115,499**	$86,731	$114,950
Deferred	**3,369**	4,884	(15,346)
Provision for income taxes	**$118,868**	$91,615	$ 99,604

The following table reconciles the Federal statutory income tax rate with the Corporation's effective income tax rate:

For the years ended December 31,	1989	1988	1987
Federal statutory income tax rate	**34.0%**	34.0%	40.0%
Increase (reduction) resulting from:			
State income taxes, net of Federal income tax benefits	**4.7**	4.5	4.1
Nondeductible acquisition costs	**1.1**	.9	.7
Other, net	**1.2**	(.6)	(.3)
Effective income tax rate	**41.0%**	38.8%	44.5%

The Financial Accounting Standards Board has issued Statement of Financial Accounting Standards No. 96, "Accounting for Income Taxes" (FAS No. 96). FAS No. 96 accounting and disclosure rules must be adopted no later than 1992 although earlier implementation is permitted. The Corporation has not implemented the new standard. When the Corporation does adopt the new accounting rules, it may record the entire catch-up effect in the year of adoption or it may retroactively restate prior financial statements. The Corporation has not decided which option it will utilize nor in which year it will implement the change. However, management believes that based on the current Federal statutory corporate income tax rate, either method, when adopted, will have a favorable impact on net income.

9. Retirement Plans and Other Benefits

The Corporation and its subsidiaries sponsor a number of defined benefit retirement plans covering substantially all employees. Plans covering most domestic salaried and hourly employees were amended in 1989 to provide retirement benefits based on individual account balances which are increased annually by pay-related and interest credits. Plans covering salaried Canadian employees provide retirement benefits based on career average or final pay compensation as defined within the provisions of the individual plans. Other plans covering salaried and hourly employees generally provide benefits based on final average pay or years of service. The Corporation's policy is to fund the normal cost plus amounts required to amortize actuarial gains and losses and prior service costs over periods ranging from 15 to 30 years. Plan assets are invested in a broadly diversified portfolio consisting primarily of domestic and international common stocks and fixed income securities. The Corporation also participates in several multiemployer retirement plans which provide defined benefits to employees covered under certain collective bargaining agreements.

The projected benefit obligation for the plans was determined using an assumed discount rate of 7.25% in 1989 and 8.5% in 1988. For both years the assumed long-term compensation increase rate was principally 6% and the assumed long-term rate of return on plan assets was 9.5%.

The funded status and amounts recognized in the consolidated balance sheets for the retirement plans were as follows:

	December 31, 1989		December 31, 1988	
(in thousands of dollars)	**Assets Exceed Accumulated Benefits**	**Accumulated Benefits Exceed Assets**	Assets Exceed Accumulated Benefits	Accumulated Benefits Exceed Assets
Actuarial present value of:				
Vested benefit obligation	**$201,581**	**$ 14,168**	$159,384	$ 10,347
Accumulated benefit obligation	**$214,435**	**$ 16,164**	$175,754	$ 11,237
Actuarial present value of projected benefit obligation	**$248,977**	**$ 22,599**	$214,354	$ 17,563
Plan assets at fair value	**268,244**	**2,906**	242,700	1,153
Plan assets greater than (less than) projected benefit obligation	**19,267**	**(19,693)**	28,346	(16,410)
Net (gain) loss unrecognized at date of transition	**(2,274)**	**4,445**	(2,508)	4,944
Prior service cost not yet recognized in earnings	**(1,331)**	**17**	668	1
Unrecognized net (gain) loss from past experience different than that assumed	**(2,807)**	**6,360**	(9,276)	4,450
Minimum liability adjustment	**—**	**(4,091)**	—	—
Prepaid pension expense (pension liability)	**$ 12,855**	**$(12,962)**	$ 17,230	$ (7,015)

Pension expense included the following components:

For the years ended December 31,	1989	1988	1987
(in thousands of dollars)			
Service cost	**$ 12,741**	$ 10,260	$ 9,134
Interest cost on projected benefit obligation	**19,262**	17,659	16,102
Investment return on plan assets	**(39,125)**	(27,332)	(15,488)
Net amortization and deferral	**16,707**	7,132	(3,449)
Corporate sponsored plans	**9,585**	7,719	6,299
Multiemployer plans	**1,252**	1,122	1,025
Other	**919**	366	305
Total pension expense	**$ 11,756**	$ 9,207	$ 7,629

The Corporation and its subsidiaries provide certain health care and life insurance benefits for retired employees. Substantially all of the Corporation's domestic employees become eligible for these benefits at normal retirement age. Retiree health care and life insurance premiums of $2.9 million, $2.4 million and $2.0 million were expensed as paid during 1989, 1988 and 1987, respectively.

10. Incentive Plan

The long-term portion of the 1987 Key Employee Incentive Plan (Plan) provides for grants or awards to senior executives and key employees of one or more of the following: performance stock units, nonqualified stock options (stock options), stock appreciation rights and restricted stock units. Stock options are granted at exercise prices of not less than 100% of the fair market value of a share of Common Stock at the time the option is granted and are exercisable for periods no longer than 10 years from the date of grant. Each option may be used to purchase one share of Common Stock. No compensation expense is recognized under the stock options portion of the Plan.

The following table provides information regarding stock options:

	Shares Under Option	
	Number of Shares	Option Price per Share
Outstanding—January 1, 1987	—	
Granted	47,150	$28
Outstanding—December 31, 1987	47,150	$28
Granted	361,550	$23¾ to 25⅜
Exercised	—	
Cancelled	(34,250)	$25⅜ to 28
Outstanding—December 31, 1988	374,450	$23¾ to 28
Granted	55,000	$26 to 26⅜
Exercised	(3,250)	$25⅜ to 28
Cancelled	(10,500)	$25⅜ to 28
Outstanding—December 31, 1989	415,700	$23¾ to 28

As of December 31, 1989, 170,813 contingent performance stock units have been granted for potential future distribution for three-year cycles ending December 31, 1989, 1990 and 1991. The Plan provides for the deferral of performance stock unit awards by participants. Deferred performance stock units and accumulated dividend amounts totaled 259,108 shares at December 31, 1989.

No stock appreciation rights or restricted stock units had been granted or awarded as of December 31, 1989.

11. Supplemental Income Statement Information

Supplemental income statement information is provided in the table below. These costs are expensed in the year incurred.

For the years ended December 31,	1989	1988	1987
(in thousands of dollars)			
Promotion	**$256,237**	$230,187	$171,162
Advertising	**121,182**	99,082	97,033
Maintenance and repairs	**58,842**	54,377	51,464
Depreciation expense	**54,543**	43,721	35,397
Rent expense	**20,033**	17,618	14,208
Research and development.	**16,094**	15,695	12,985

Rent expense represents the cost of all operating leases, principally pertaining to certain administrative buildings, distribution facilities and transportation equipment. Future minimum rental payments under noncancelable operating leases with a remaining term in excess of one year as of December 31, 1989, are: 1990, $8.5 million; 1991, $8.3 million; 1992, $7.1 million; 1993, $4.8 million; 1994, $7.3 million; 1995 and beyond, $120.3 million.

Amounts for taxes other than payroll and income taxes, amortization of intangibles resulting from business acquisitions, and royalties are less than 1% of net sales.

12. Supplemental Balance Sheet Information

Accounts Receivable — Trade

Receivables, as shown on the consolidated balance sheets, are net of allowances for doubtful accounts of $7.7 million and $8.4 million at December 31, 1989 and 1988, respectively.

Inventories

The majority of the Corporation's inventories are valued under the last-in, first-out (LIFO) method. The remaining inventories are stated at the lower of first-in, first-out (FIFO) cost or market. All inventories are stated at amounts that do not exceed realizable values. LIFO cost of inventories valued using the LIFO method was $239.4 million in 1989 and $230.6 million in 1988. Total inventories were as follows:

December 31,	1989	1988
(in thousands of dollars)		
Raw materials	**$139,854**	$175,588
Goods in process	**28,707**	31,459
Finished goods	**203,136**	180,595
Inventories at FIFO	**371,697**	387,642
Adjustment to LIFO	**(61,860)**	(78,887)
Total inventories	**$309,837**	$308,755

Property, Plant and Equipment

Major classes of property, plant and equipment were as follows:

December 31,	1989	1988
(in thousands of dollars)		
Land	**$ 20,022**	$ 14,821
Buildings	**223,600**	203,775
Machinery and equipment	**906,705**	800,275
	1,150,327	1,018,871
Accumulated depreciation	**320,422**	282,859
Property, plant and equipment, net	**$ 829,905**	$ 736,012

Property, plant and equipment balances include construction in progress of $95.8 million and $59.0 million at December 31, 1989 and 1988, respectively.

Accrued Liabilities

Accrued liabilities were as follows:

December 31,	1989	1988
(in thousands of dollars)		
Payroll and other compensation costs	**$ 45,102**	$ 42,502
Advertising and promotional expenses	**47,469**	44,293
Other	**50,285**	57,531
Total accrued liabilities	**$142,856**	$144,326

13. Segment Information

The Corporation operates in one line of business —consumer foods, involving the manufacture, distribution and sale of chocolate, confectionery, pasta and other food products.

The table below presents information about the Corporation's domestic and foreign operations. The foreign amounts presented represent Canadian operations. Transfers of product between geographic areas are not significant.

For the years ended December 31,	**1989**	1988	1987
(in thousands of dollars)			
Net sales:			
Domestic	**$2,235,728**	$1,968,647	$1,739,532
Foreign	**185,260**	199,401	124,284
Total	**$2,420,988**	$2,168,048	$1,863,816
Income from continuing operations before interest and income taxes:			
Domestic	**$ 306,705**	$ 256,657	$ 238,806
Foreign	**3,631**	9,418	7,285
Total	**$ 310,336**	$ 266,075	$ 246,091
Identifiable assets at December 31:			
Domestic	**$1,561,187**	$1,506,037	$1,311,921
Foreign	**252,914**	258,628	232,433
Total	**$1,814,101**	$1,764,665	$1,544,354

14. Quarterly Data (Unaudited)

The following is a summary of quarterly data:

(in thousands of dollars except per share amounts)

Year 1989	**First**	**Second**	**Third**	**Fourth**	**Year**
Net sales	**$572,245**	**$485,473**	**$682,375**	**$680,895**	**$2,420,988**
Gross profit	**233,620**	**188,378**	**262,144**	**281,234**	**965,376**
Net income	**39,689**	**25,080**	**52,195**	**54,090**	**171,054**
Net income per share	**.44**	**.28**	**.58**	**.60**	**1.90**

Year 1988	First	Second	Third	Fourth	Year
Net sales	$495,044	$403,112	$597,642	$672,250	$2,168,048
Gross profit	193,919	155,487	228,432	263,752	841,590
Income from continuing operations	36,154	20,446	41,674	46,232	144,506
Discontinued operations	755	8,203	60,485	—	69,443
Net income	36,909	28,649	102,159	46,232	213,949
Income from continuing operations per share	.40	.23	.46	.51	1.60
Net income per share	.41	.32	1.13	.51	2.37

The weighted average number of shares outstanding was 90,186,336 for all periods presented.

Responsibility for Financial Statements

Hershey Foods Corporation is responsible for the financial statements and other financial information contained in this report. The Corporation believes that the financial statements have been prepared in conformity with generally accepted accounting principles appropriate under the circumstances to reflect in all material respects the substance of applicable events and transactions. In preparing the financial statements, it is necessary that management make informed estimates and judgments. The other financial information in this annual report is consistent with the financial statements.

The Corporation maintains a system of internal accounting controls designed to provide reasonable assurance that financial records are reliable for purposes of preparing financial statements and that assets are properly accounted for and safeguarded. The concept of reasonable assurance is based on the recognition that the cost of the system must be related to the benefits to be derived. The Corporation believes its system provides an appropriate balance in this regard. The Corporation maintains an Internal Auditing Department which reviews the adequacy and tests the application of internal accounting controls.

The financial statements have been audited by Arthur Andersen & Co., independent public accountants, whose appointment was ratified by stockholder vote at the stockholders' meeting held on April 24, 1989. Their report expresses an opinion that the Corporation's financial statements are fairly stated in conformity with generally accepted accounting principles, and they have indicated to us that their examination was performed in accordance with generally accepted auditing standards which are designed to obtain reasonable assurance that the financial statements are free of material misstatement.

The Audit Committee of the Board of Directors of the Corporation, consisting solely of outside directors, meets regularly with the independent public accountants, internal auditors and management to discuss, among other things, the audit scopes and results. Arthur Andersen & Co. and the internal auditors both have full and free access to the Audit Committee, with and without the presence of management.

Report of Independent Public Accountants

To the Stockholders and Board of Directors of Hershey Foods Corporation:

We have audited the accompanying consolidated balance sheets of Hershey Foods Corporation (a Delaware Corporation) and subsidiaries as of December 31, 1989 and 1988, and the related consolidated statements of income, stockholders' equity and cash flows for each of the three years in the period ended December 31, 1989, appearing on pages 22, 24, 26, 28 and 29 through 36. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Hershey Foods Corporation and subsidiaries as of December 31, 1989 and 1988, and the results of their operations and cash flows for each of the three years in the period ended December 31, 1989 in conformity with generally accepted accounting principles.

Arthur Andersen & Co.

New York, N.Y.
February 2, 1990

Directors and Senior Management

BOARD OF DIRECTORS

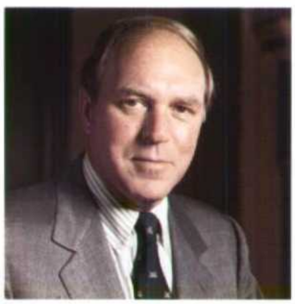
Richard A. Zimmerman
Chairman of the Board
and Chief Executive Officer

Howard O. Beaver, Jr.
Retired Chairman of the Board
Carpenter Technology
Corporation
Reading, Pa.

John F. Burlingame
Retired Vice Chairman of the
Board and Executive Officer
General Electric Company
Stamford, Conn.

Thomas C. Graham
President, USS
a division of USX Corporation
Pittsburgh, Pa.

Kenneth V. Hatt
Chairman of the Board
Hershey Trust Company
Hershey, Pa.



John C. Jamison
Dean, Graduate School of
Business Administration
The College of William & Mary
Williamsburg, Va.

Dr. Sybil C. Mobley
Dean, School of Business
and Industry
Florida Agricultural and
Mechanical University
Tallahassee, Fla.

Francine I. Neff
Vice President and Director
NETS Inc.
privately-held
investment company
Albuquerque, N.M.

John M. Pietruski
Retired Chairman of the Board
and Chief Executive Officer
Sterling Drug Inc.
New York, N.Y.

H. Robert Sharbaugh
Retired Chairman
and Chief Executive Officer
Sun Company, Inc.
Radnor, Pa.

Joseph P. Viviano
President
Hershey Chocolate U.S.A.

Kenneth L. Wolfe
President and Chief
Operating Officer

Audit Committee
Dr. Sybil C. Mobley, *Chair*
John F. Burlingame
Thomas C. Graham
John M. Pietruski
H. Robert Sharbaugh

Compensation and Executive Organization Committee
John F. Burlingame, *Chair*
Howard O. Beaver, Jr.
John C. Jamison
Francine I. Neff
John M. Pietruski

Employee Benefit Committee
Howard O. Beaver, Jr., *Chair*
Thomas C. Graham
Kenneth V. Hatt
Francine I. Neff
H. Robert Sharbaugh

Executive Committee
Richard A. Zimmerman, *Chair*
Joseph P. Viviano
Kenneth L. Wolfe

Nominating Committee
John C. Jamison, *Chair*
Kenneth V. Hatt
Dr. Sybil C. Mobley
Richard A. Zimmerman

CORPORATE OFFICERS

Richard A. Zimmerman
Chairman of the Board and Chief Executive Officer

Kenneth L. Wolfe
President and Chief Operating Officer

William Lehr, Jr.
Senior Vice President and Secretary

Michael F. Pasquale
Senior Vice President and Chief Financial Officer

Kenneth L. Bowers
Vice President Corporate Communications

Frank Cerminara
Vice President Corporate Development and Commodities

Charles E. Duroni
Vice President and General Counsel

Sharon A. Lambly
Vice President Human Resources

Dr. Barry L. Zoumas
Vice President Science and Technology

Thomas C. Fitzgerald
Treasurer

John B. Stiles
Controller and Chief Accounting Officer

DIVISION PRESIDENTS

William F. Christ
President Hershey International

Richard W. Meyers
President Hershey Canada Inc.

C. Mickey Skinner
President Hershey Pasta Group

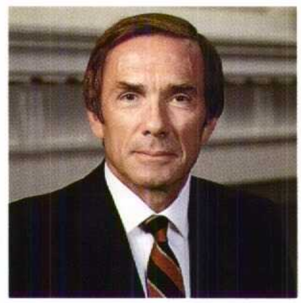
Joseph P. Viviano
President Hershey Chocolate U.S.A.

William Lehr, Jr.

Michael F. Pasquale

Kenneth L. Bowers

Frank Cerminara



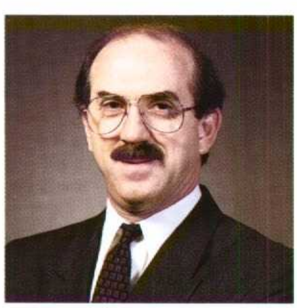
Charles E. Duroni

Sharon A. Lambly

Dr. Barry L. Zoumas

Thomas C. Fitzgerald

John B. Stiles



William F. Christ

Richard W. Meyers

C. Mickey Skinner

HERSHEY FOODS CORPORATION

SIX-YEAR CONSOLIDATED FINANCIAL SUMMARY

(all dollar and share amounts in thousands except market price and per share statistics)	**1989**	1988	1987	1986	1985	1984
Summary of Operations[a]						
Net Sales	**$ 2,420,988**	2,168,048	1,863,816	1,635,486	1,526,584	1,423,396
Cost of Sales	**$ 1,455,612**	1,326,458	1,149,663	1,032,061	982,370	934,817
Selling, Marketing and Administrative	**$ 655,040**	575,515	468,062	387,227	345,299	309,587
Interest Expense, net	**$ 20,414**	29,954	22,413	8,061	10,240	8,325
Income Taxes	**$ 118,868**	91,615	99,604	100,931	91,910	82,986
Income from Continuing Operations	**$ 171,054**	144,506	124,074	107,206	96,765	87,681
Discontinued Operations	**$ —**	69,443	24,097	25,558	15,462	21,001
Net Income	**$ 171,054**	213,949	148,171	132,764	112,227	108,682
Income Per Share from Continuing Operations[b]	**$ 1.90**	1.60	1.38	1.15	1.03	.93
Net Income Per Share[b]	**$ 1.90**	2.37	1.64	1.42	1.19	1.16
Weighted Average Shares Outstanding[b]	**90,186**	90,186	90,186	93,508	94,011	94,011
Dividends Paid on Common Stock	**$ 55,431**	49,433	43,436	40,930	37,386	37,073
Per Share[b]	**$ .740**	.660	.580	.520	.475	.413
Dividends Paid on Class B Common Stock	**$ 10,161**	9,097	8,031	7,216	6,556	1,607
Per Share[b]	**$ .665**	.595	.525	.472	.428	.105
Income from Continuing Operations as a Percent of Net Sales	**7.1%**	6.7%	6.7%	6.6%	6.3%	6.2%
Depreciation	**$ 54,543**	43,721	35,397	31,254	28,348	22,725
Advertising	**$ 121,182**	99,082	97,033	83,600	77,135	71,070
Promotion	**$ 256,237**	230,187	171,162	122,508	105,401	94,921
Payroll	**$ 340,129**	298,483	263,529	238,742	222,267	208,395
Year-end Position and Statistics[a]						
Working Capital	**$ 281,821**	273,716	190,069[c]	174,147	225,345	187,642
Property, Plant and Equipment, net	**$ 829,905**	736,012	564,472	502,241	452,756	430,359
Capital Additions	**$ 162,032**	101,682	68,504	74,452	61,361	45,258
Total Assets	**$ 1,814,101**	1,764,665	1,544,354	1,262,332	1,116,074	1,052,161
Long-term Debt	**$ 216,108**	233,025	280,900	185,676	86,986	103,155
Stockholders' Equity	**$ 1,117,050**	1,005,866	832,410	727,941	727,899	660,928
Current Ratio	**2.0:1**	1.8:1	1.7:1[c]	2.0:1	2.4:1	2.1:1
Capitalization Ratio	**17%**	22%	27%	21%	12%	14%
Net Book Value Per Share[b]	**$ 12.39**	11.15	9.23	8.07	7.74	7.03
Operating Return on Average Stockholders' Equity	**16.1%**	17.5%	19.0%	18.2%	16.2%	17.3%
Operating Return on Average Invested Capital	**13.2%**	13.3%	13.5%	13.5%	12.7%	13.5%
Full-time Employees at Year-end	**11,800**	12,100	10,540	10,210	10,380	10,150
Stockholders' Data						
Outstanding Shares of Common Stock and Class B Common Stock at Year-end[b]	**90,186**	90,186	90,186	90,186	94,011	94,011
Market Price of Common Stock:						
Year-end[b]	**$ 35⅞**	26	24½	24⅝	17⅛	12⅞
Range During Year[b]	**$36⅞–24¾**	28⅝–21⅞	37¾–20¾	30–15½	18⅜–11⅝	13¾–9⅜
Number of Common Stock and Class B Common Stock Holders at Year-end	**29,998**	30,430	29,151	23,502	17,529	16,729

Notes:

[a] All amounts for years prior to 1988 have been restated for discontinued operations, where applicable. Operating Return on Average Stockholders' Equity and Operating Return on Average Invested Capital have been computed using Net Income, excluding gain on disposal of discontinued operations.

[b] All share and per share amounts for years prior to 1987 have been adjusted for the three-for-one stock split effective September 15, 1986.

[c] Amounts exclude net assets of discontinued operations.

INVESTOR INFORMATION

Stockholders

As of December 31, 1989, Hershey Foods Corporation had outstanding 74,907,032 shares of Common Stock and 15,279,304 shares of Class B Common Stock owned by 29,998 registered stockholders of record.

Stock Market Data

Hershey Foods Corporation's Common Stock is listed and traded principally on the New York Stock Exchange under the ticker symbol "HSY." Class B Common Stock is not listed for trading. The stock tables of most financial publications list the Corporation as "Hershey." Options on the Corporation's Common Stock are traded on the American Stock Exchange.

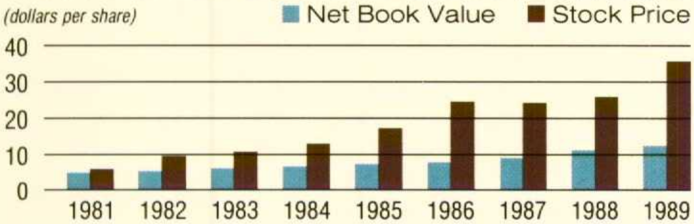
Common Stock Profile

	Common Stock Price			Dividends Paid	
1989	High	Low	Close	Common	Class B
(calendar quarter)					
1st Qtr.	$27¼	$24¾	$26½	$.1750	$.1575
2nd Qtr.	34	26	33⅛	.1750	.1575
3rd Qtr.	35½	31¼	33	.1950	.1750
4th Qtr.	36⅞	31¼	35⅞	.1950	.1750

Approximate Composite Trading Volume (Shares)

Year	Annual	Average Daily
1989	41,220,000	164,000
1988	46,693,000	185,000
1987	48,145,000	190,000

YEAR-END NET BOOK VALUE & STOCK PRICE



Annual Meeting

The Annual Meeting of Stockholders will be held at 2:00 p.m. on Monday, April 30, 1990, at the Hershey Theatre, East Caracas Avenue (near Cocoa Avenue) in Hershey, Pa. A formal notice of this meeting, together with a proxy statement, will be mailed to stockholders on or about March 8, 1990.

Dividend Policy

Dividends on Hershey Foods Corporation's Common Stock and Class B Common Stock are declared by the Board of Directors and normally are paid in the months of March, June, September and December.

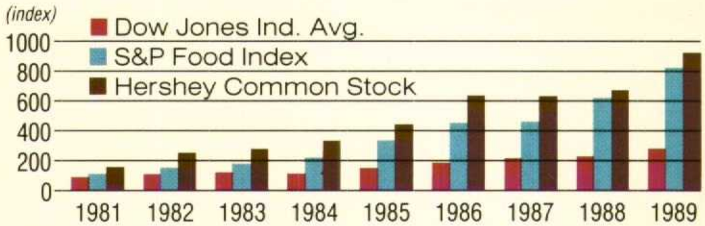
The dividend to be paid on the Common Stock in March 1990 will be the 241st consecutive regular dividend paid by the Corporation. The dividend rate has been increased annually for 15 consecutive years. Historically, the Corporation has targeted approximately one-third of net income as dividends to stockholders.

Dividend Reinvestment Service

The Corporation offers a Dividend Reinvestment Service whereby stockholders may build their investment by reinvesting dividends without paying brokerage commissions or service fees. Participants also may make voluntary cash payments of up to $20,000 annually, for which there only are nominal commission and service fees. Approximately one-third of Hershey Foods Corporation's registered stockholders are enrolled in this service. For more information, write to:

Manufacturers Hanover Trust Co.
Dividend Reinvestment Department
P. O. Box 24850
Church Street Station
New York, N.Y. 10242-4850
Telephone: (212) 613-7147

HERSHEY FOODS COMMON STOCK PERFORMANCE vs. SELECTED INDICES



Indexed as of year-end 1980

Form 10-K

Form 10-K, filed annually in March with the Securities and Exchange Commission, is available without charge by writing to: Office of the Corporate Secretary
Hershey Foods Corporation
P. O. Box 814
Hershey, Pa. 17033-0814
Telephone: (717) 534-7527

Stockholder Inquiries

Questions relating to stockholder records, change of ownership, change of address and dividend payments should be sent to the Corporation's Transfer Agent, Manufacturers Hanover Trust Co., listed on the inside front cover.

Financial Information

Security analysts, investment managers and stockholders should direct financial information inquiries to the Investor Relations contact listed on the inside front cover. ■

Hershey Foods Corporation
Hershey, Pennsylvania 17033, U.S.A.